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Supreme Court, U.S.
JUL 22 1993
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No. 92-1974

In The

Supreme Court of the United States

October Term, 1993

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA,

Petitioner,

vs.

LEONARD HELFAND and EILEEN HELFAND,

Respondents.

On Petition For A Writ Of Certiorari To The California Court Of Appeal, First Appellate District, Division Four

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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I. QUESTIONS PRESENTED FOR REVIEW

Whether, consonant with its obligation to give full faith and credit to a judgment or final order of a federal court, a state court may determine, based upon its review of the facts and circumstances attendant to entry of a federal bankruptcy order approving a compromise, whether that federal order should be given preclusive or *res judicata* effect as to parties before the state court who were not parties in the bankruptcy proceeding and were not parties to the "compromise".

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II. OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Petitioner National Union argued below – correctly – that the California state court *did have* jurisdiction to determine the full faith and credit and *res judicata* effects of the Bankruptcy Court order. Having urged the California court to make the *res judicata* determination, petitioner now finds that it does not like the *result* it received. Recognizing, as it must, the futility of asking this Court to retry the factual issues that gave rise to that result, petitioner now rotates 180 degrees and asserts that the state court had no subject matter jurisdiction after all.[1]

Petitioner's about-face to recast the question as one of subject matter jurisdiction is certainly understandable since the case below presents no substantially controverted issue relating to the federalism precepts of either full faith and credit or *res judicata*. What the California court did below is perfectly consistent with, not only the teachings of this Court, but with the manner in which the *res judicata* effects of prior federal orders are determined by other federal and state courts throughout the land.

In attempting to manufacture grounds for *certiorari*, National Union frames a jurisdictional dispute where none existed, and seeks to portray an unconstitutional encroachment upon federal jurisdiction. To the contrary, the federal and state courts below exercised admirable deference to the jurisdiction of each other, each acting where it should act, and each giving due regard to the

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[1] *E.g.*, Petition at 14: "The California courts clearly lacked subject matter jurisdiction . . . "

acts of the other. At every turn, petitioner National Union sought to have either the district court or the bankruptcy court interfere with this and related litigation in the California court. On each occasion, the federal court declined National Union's application and, indeed, the bankruptcy court specifically found that the California court was the proper forum to adjudicate issues of interpretation of the insurance policy and insurance coverage – the precise issues decided by the California court below.[2]

This Court is faced here with a straightforward legal issue: Although giving full faith and credit to a prior bankruptcy order, does the state court have power to then determine the *res judicata* effect of that order upon a litigant who urges that he was not a party to the prior bankruptcy proceeding, and thus is not bound by it? Certainly a state court has the jurisdictional power to do this. *E.g., Parsons Steel v. First Alabama Bank*, 474 U.S. 518 (1986) (Rehnquist, J., for unanimous court). None of the factors implicating the grant of *certiorari*, as set forth in Rule 10 of this Court, is present here. What remains is the issue of whether the California court made a correct *factual* determination of whether respondents here were, in fact, parties before the bankruptcy court. Review of that fact specific determination, amply supported by the record, is certainly not grist for this Court's mill.

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[2] *See* Part II(A), *infra*.

III. STATEMENT OF THE CASE

The complex nature of the facts supporting the California court's[3] determination that respondents herein were not "parties" to the bankruptcy proceeding are set forth in some detail in the opinions below. To the extent possible, we will not reiterate those facts here, but will focus upon important aspects of the case about which petitioner's discussion here has been incomplete or incorrect.

A. Petitioner's Attempted Characterization To The Contrary Notwithstanding, The Federal And State Courts In This Action Exhibited Exemplary Deference To Each Other's Jurisdiction

In an attempt to construct a rationale for *certiorari*, petitioner National Union here describes a state court that has flouted the jurisdiction of a bankruptcy court. In point of fact, however, the bankruptcy court itself had specifically determined that the California court should render all decisions regarding the interpretation of the subject insurance policy and the issue of insurance coverage for various state court claimants, including respondents Helfand. Indeed, both the federal and state courts were well aware of the jurisdiction being exercised by the other. Petitioner National Union, at every opportunity, sought relief from the United States District Court and

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[3] For ease of reference, the term the "California court" refers to the Court of Appeal, and its holding and opinion affirming the trial court judgment below "insofar as it declares there is $10 million in coverage for third year claims." Petitioner's Appendix ("PA") at 52a.

the United States Bankruptcy Court, each time attempting to divest the state court of jurisdiction. As is described below, on all occasions the district court and the bankruptcy court rejected petitioner's importunings, and allowed this case and related litigation to continue in state court.

Shortly after this *Helfand* action was filed in state court, petitioner removed it to the district court, arguing that its relationship to the bankruptcy case provided federal jurisdiction. The district court disagreed, and remanded the case. Respondents' Appendix ("RA"), at A1-A4. Thereafter, National Union interpled a bond for $10 million in the bankruptcy court and sought an injunction from the bankruptcy court enjoining prosecution of this case as well as other state court related litigation. The bankruptcy court refused to enjoin this state court litigation, recognizing that issues of insurance coverage were properly before the state court, and that there was no predominant federal interest justifying an injunction.[4] The bankruptcy judge recognized that wide-ranging and complex litigation required a "strong judicial hand", but, in this case, deferred to the state court to provide that judicial leadership. RA A10. The bankruptcy judge further recognized that the bankruptcy estate was simply a claimant against the insurance policy along with hundreds of others, such as the respondents, and expressed

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[4] Indeed, prior to National Union's filing of an interpleader adversary proceeding, in its October 5, 1987 order granting relief from the automatic stay, the bankruptcy court expressly determined that all issues of insurance coverage should be determined by the state court in this *Helfand* action. PA 81a.

doubt whether the insurance proceeds were property of the estate. RA A8-A10; *see, In re Louisiana World Exposition, Inc.*, 832 F.2d 1391, 1399-1400 (5th Cir. 1987) (holding that D&O policy proceeds are *not* the property of the bankruptcy estate of the corporation, but rather the property of the insured directors and officers). Indeed, the Bankruptcy Court always deferred, and later formally abstained, in favor of the state court, from deciding any issue involving interpretation of the insurance policy or limits of coverage. RA A14-A15.

After judgment was entered at the trial court in this matter, petitioner returned to the district court seeking an injunction enjoining respondents from enforcing the judgment below. PA 29a. In denying the injunction, in a 12-page Memorandum of Decision, RA A12-A23, the district court identified the controlling issue as being *res judicata* of the bankruptcy order and the controlling questions – including notice, representation and privity – as having been presented to and decided by the state court below. The district court rejected National Union's application for injunction, finding that it would "be an unwarranted and unconscionable intrusion upon the California processes, wholly at odds with governing principles of federalism, comity, and equity." RA A22.

In its opinion, the district court recognized that the fact situation was "murky" and implied strongly that the reason petitioner sought not to go to the bankruptcy court with its latest request for injunction was because the state court had done exactly what the bankruptcy

court had contemplated – decide insurance policy interpretation and coverage issues.[5]

National Union appealed the district court's decision. The Ninth Circuit summarily affirmed that decision and dismissed National Union's appeal. PA 29a.

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[5] The district court's opinion noted:

> The factual situation is rendered more murky than otherwise by the fact that the bankruptcy court judge, King, C.J., rendered subsequent decisions which strongly indicate that he had no intention of effecting matters of coverage, policy limits and the like, but was leaving such determinations to the state court judge who was presiding over the state coordinated proceedings.
>
> For example on July 28, 1986 King approved the compromise over the D&O policy. On October 30, 1987 National Union sought a preliminary injunction from Judge King, enjoining the then ongoing state and federal actions. This request was refused. On April 29, 1988 National Union sought a Finding that the Order of July 28, 1986 had limited coverage under the D&O Policy to $10 million. This, and the accompanying motion for preliminary injunction of ongoing state and federal court litigation, were denied by King on June 22, 1988. . . .
>
> . . . [O]n September 7, 1990, King tentatively granted the *Helfand* plaintiffs motion for complete abstention from determination of all remaining issues in the interpleaded action. This order was conditioned only upon the finding of a suitable mechanism to distribute the interpleaded funds.
>
> All this causes me to wonder why plaintiffs [National Union] chose this district court in which to seek injunctive relief rather than the bankruptcy court which made the order whose preclusive effect is in issue here.

RA A14-A15.

B. National Union's Unilateral Cancellation Of The Policy Constituted Bad Faith Vis-A-Vis Respondents, Notwithstanding Any Later Compromise Reached By National Union And TEC

1. Once Injury Had Occurred, Respondents Had A Personal Interest In The Third Year Coverage Of The Policy

Fundamental to this declaratory relief action is the proposition that an insurance company may not unilaterally and arbitrarily cancel a liability policy, particularly when injured persons have claims against that liability policy. California law in this regard was settled in an opinion written for the California Supreme Court by Justice Traynor. *Shapiro v. Republic Indemnity Co. of America*, 52 Cal. 2d 437 (1959). The facts were not dissimilar from this case. After an accident had occurred, the insurance company and the insured filed suit in state court for a decree of reformation. The reformation of the policy was such that it would have meant the injured party's claim was not covered. After receiving a judgment against the insureds, the injured party then sued the insurance company to recover the judgment. The insurance company defended on the basis that the judgment in the reformation action between it and the insured was *res judicata*. Just as did respondents in this case, the injured plaintiff in *Shapiro* argued that she was not bound by the judicial judgment of reformation, because she was not a party to that litigation. Discussing cases from around the country, including the federal decision of *New Amsterdam Casualty Co. v. Murray*, 242 F.2d 549 (6th Cir. 1957), the California Supreme Court observed that:

> [T]he injured person's rights against the tort feasor's insurer arise upon the happening of the accident and cannot thereafter be abridged by a judgment to which the injured person is not a party. A judgment cancelling the policy . . . was held not to be binding on the injured person. [Citations.] (52 Cal. 2d at 440.)

Thus, in refusing to give *res judicata* effect to the judgment of reformation, the California Supreme Court in *Shapiro* found that the injured persons "had an interest [in the liability policy] that could not be altered or conditioned by independent action of the insurer and the insured. [Citation.] Nor can these rights be conclusively determined against the injured persons in an action to which they were not made parties." 52 Cal. 2d at 440.[6]

2. It Was National Union's Unilateral Decision To Cancel The Policy And Frustrate Respondents' Interest In The Policy That Was Held To Be Arbitrary And In Bad Faith, Not National Union's Participation In A Compromise Between National Union and TEC

Without regard for the rights of injured parties in the policy, National Union unilaterally "cancelled"[7] the third

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[6] Accord, *General Insurance Company of America v. Whitmore*, 235 Cal. App. 2d 670, 674 (1965); *General of America Insurance Company v. Lilly*, 258 Cal. App. 2d 465, 472 (1968); *see also, Courtney v. Waring*, 191 Cal. App. 3d 1434, 1448 (1987).

[7] We use "cancelled" because the California court applying California law held that National Union's decision to cancel the D&O policy was "arbitrary" and "without legal justification", and thus improper, such that coverage exists under the third policy year. PA 29a, 49a, 50a, 86a.

year coverage of the policy. National Union did this *without prior notice* to TEC, and certainly without any Bankruptcy Court approval. As is detailed in some length in the opinion of the Court of Appeal, under California law, an insurance company does not have an unfettered right to cancel coverage, notwithstanding a mutual cancellation clause to that effect. PA 46a-51a. Any cancellation by an insurance company is subject to the requirements of the implied covenant of good faith and fair dealing. *Spindle v. Travelers Ins. Companies,* 66 Cal. App. 3d 951, 957-958 (1977).

The Court of Appeal examined in some detail the evidence demonstrating that National Union's cancellation was arbitrary, and that National Union, by attempting to cancel unilaterally, sought to exalt its interest above the interests of the insureds and the injured parties. The California court found the attempt at cancellation without justification, in part, because it was based upon mere allegations of fraud at TEC that were not verified, and because the attempt at cancellation sought to divest all insured directors and officers of TEC of their liability coverage, even though there was no suspicions that most of the insureds, especially the "outside directors" had committed any fraud.[8] PA 48a-49a. And finally,

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[8] Technical Equities gave written notice of potential claims to National Union by letter dated January 30, 1986. PA 65a. Technical Equities filed for Chapter 11 protection under the bankruptcy laws on February 7, 1986. PA 66a. Commencing at that time, hundreds of individual lawsuits by hundreds and hundreds of T.E. investors and clients were filed against the TEC officers and directors in California state court, including a lawsuit by respondents and plaintiffs Leonard and Eileen Helfand.

the California court recognized that a cancellation of a prepaid policy when loss is "imminent and unavoidable" is not in good faith.[9] PA 50a-51a.

In March 1986, without consulting with TEC and certainly without the approval of the bankruptcy court, National Union decided to cancel Technical Equities' prepaid 1984-1987 D&O policy. PA 47a. National Union admitted that it knew that TEC had prepaid its premiums on the three-year policy, that lawsuits were pending against TEC officers and directors who were insureds under the D&O policy, that additional lawsuits would be filed against the insureds, and that these were significant monetary claims against the insureds. PA 47a.

According to *National Union* the sole reason for cancellation of the D&O policy was that its senior underwriter had a " 'gut feel[ing]' that some individuals at Technical Equities were 'guilty of gross fraud.' " PA 47a-48a. His understanding concerned one to five individuals; he was not aware of any information indicating that the two dozen other T.E. officers and directors, including the outside directors, who were also insureds under the D&O policy, were engaged in "gross fraud". PA 48a. As National Union admitted, if "gross fraud" had been committed by any of its insureds, those acts would be *excluded* from coverage, and there would have been no need to cancel the policy. PA 48a. Allowing the policy exclusions to take effect would have allowed coverage to continue as to the other "innocent" insureds who were not known or suspected of having committed any wrongful acts at the time of cancellation. "Nonetheless, he still felt a need to cancel the policy because they 'weren't sure where the corporation was going' and 'what was going to occur going forward.' " PA 48a.

There was no factual investigation undertaken by anyone at National Union prior to the cancellation. PA 48a. The "reason for cancelling was not communicated to anyone involved in or affected by the cancellation, including National Union's own staff, Technical Equities, the insured directors and officers, and the insurance broker." PA 49a.

[9] For example, the California court cited, at PA 50a, a venerable case where the insurer gives notice of cancellation when

This does *not* mean that the California court determined that the bankruptcy order approving the compromise between TEC and National Union was invalid. To the contrary, after TEC had raised with National Union the argument that National Union's "cancellation" was invalid as violative of the automatic bankruptcy stay of 11 U.S.C. §362, National Union and TEC bargained. *They* reached a compromise. The D&O liability policy contains two parts, one of which provides coverage to injured parties such as respondents Helfand, the other provided TEC, the corporation, with the right to receive reimbursement from National Union for claims paid by it on behalf of the officers and directors (the "corporation reimbursement" portion). PA 2a, 55a, 80a. In its bargain with National Union, TEC gave up *its* right to claim under the corporation reimbursement portion for up to $10 million in coverage for indemnification payments made to the directors and officers in the third year of the policy. In return, TEC received, and National Union provided, a $5 million policy covering post-bankruptcy acts.

Thus, whether or not National Union had the unilateral right to cancel its third year obligations to TEC (as opposed to the respondents), the bargain that TEC and National Union reached was certainly a matter that the Bankruptcy Court could approve. On the other hand, as

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fire is approaching the insured property: "Of what avail would it be, to take a policy against fire, to permit its cancellation when fire is approaching?" *Home Ins. Co. v. Hecht*, 65 Ill. 111, 114 (1872). *See also, Harman v. American Casualty Co. of Reading, Pa.*, 155 F. Supp. 612, 613-614 (S.D. Cal. 1975) ; *Murphy v. Seed-Roberts Agency, Inc.*, 79 Mich. App. 1 (1977); *L'Orange v. Medical Protective Company*, 394 F.2d 57 (6th Cir. 1968).

the California court found, the cancellation and replacement of the cancelled policy with a new policy covering post-bankruptcy acts could benefit National Union and could benefit TEC, but was of absolutely no benefit to parties, such as respondents here, who were damaged by pre-bankruptcy acts, or to the insured directors and officers who would need the bargained-for and paid-for coverage for their pre-bankruptcy acts.

Contrary to National Union's mischaracterization, the decisions below, fairly read, do not hold National Union in "bad faith" for participating in the bankruptcy court process approving the compromise between TEC and National Union. To the contrary, it was National Union's unjustified and arbitrary "cancellation" of the policy as it affected respondents' rights, which began months prior to the bargain approved by the Bankruptcy Court, that constituted bad faith on National Union's part.

IV. CERTIORARI SHOULD BE DENIED HERE BECAUSE THE LEGAL ISSUES RAISED BY THE PETITION ARE WELL ESTABLISHED, UNDISPUTED AND WERE CORRECTLY APPLIED BELOW

The real issue raised by this petition is the proper effect of a final order of a Bankruptcy Court upon subsequent state court litigation. Analysis of this issue raises two questions of federal law: (i) whether the state court is required to give full faith and credit to the Bankruptcy Court order, and (ii) whether in seeking to give full faith

and credit to that federal judgment, the state court is empowered to determine the scope of the binding effect of that order under the principles of *res judicata*.

These are, no doubt, important questions; but the significance of the questions has led to answers that are not, and, indeed, cannot be, controverted. The clear, consistent teaching of this Court is, and has been, that a state court *must* give full faith and credit to a final order of a Bankruptcy Court, *and* that the state court *does have* jurisdictional power to then determine the binding effect of the federal judgment upon the parties and issues before the state court.

The question presented by petitioner, whether a state court lacks subject matter jurisdiction to "nullify final order of a United States Bankruptcy Court" not only answers itself, but has no relevance to the proceedings below. The California court could not, and did not, nullify the Bankruptcy Court order; by the same token, the California court could, and did, decide whether that order was binding on litigants found not to be parties to the bankruptcy proceeding. Although *now* characterizing the state court's decision as an extra-jurisdictional encroachment upon federal law, *below* petitioner National Union recognized that the California court did have jurisdiction to act as it did.[10] Thus, in an attempt to manufacture an appropriate issue for *certiorari*, National Union

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[10] In arguing below that the California court *did have* subject matter jurisdiction to render a determination regarding the *res judicata* effect of the bankruptcy order, National Union demonstrates the thin contrived nature of its argument here that the California court exceeded its jurisdiction. Speaking of the same court that it here urges exceeded its jurisdiction, National Union

has come full circle, abandoning its argument below that the California court *should decide* the *res judicata* effect of the federal court's order, now arguing that the California court had no jurisdiction to do so.

Indeed, National Union below framed the issue in exactly the manner in which *respondents* frame it here. As National Union put the question to the California Court of Appeal:

> Therefore, the issue whether the bankruptcy court's order was entitled to full faith and credit and should be given res judicata effect in this action is squarely presented by this appeal. (PA 137a (Excerpts from Appellant's Opening Brief).)

National Union seeks to jettison the real issue, and substitute a contrived jurisdictional "end-run," because, in the context of this case, neither the application of the full faith and credit obligation nor the determination of the *res judicata* issue implicates "an important question of federal law which has not been, but should be, settled by this Court."[11]

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claimed below: "[I]ssue and claim preclusion arguments may be made in state court after the federal court declines to grant an injunction." PA 137a (citing *Golden v. Pacific Maritime Ass'n.*, 786 F.2d 1425, 1427 (9th Cir. 1986)).

[11] *See*, Rule 10.1(c) of Rules of the Supreme Court of the United States. Indeed, no other principle supporting the grant of *certiorari* is present here, such as a conflict of decisions between the circuits or between the circuit or the states.

A. The California Court Was Required To, And Did, Give Full Faith And Credit To The Bankruptcy Court Order

A final order of a Bankruptcy Court may be treated as a final judgment.[12] Thus, when that order was raised below as an affirmative defense by National Union, the doctrine of full faith and credit was implicated.

Although neither the full faith and credit clause of the Constitution, Article IV, Section 1, nor the full faith and credit statute, 28 U.S.C. §1738, directly addresses the issue, there "is a clearly established rule that state courts *must give full faith and credit* to the proceedings of federal courts[.] That this is the rule is *beyond doubt*. . . . "[13] Indeed, the concept that a state court must afford full faith and credit to a federal judgment is so fundamentally rooted in the concept of federalism that it is "unthinkable"[14] to even suggest that a state court could disregard a federal judgment. Throughout the land, state courts

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[12] Clearly the subject bankruptcy order is "final". The extent to which an Order Approving Compromise is a "judgment", particularly as the subject bankruptcy hearing was not a decision ending the litigation on the merits (*see*, PA 35a), is not of import herein. *Cf., Chicot County Drainage Dist. v. Baxter State Bank*, 308 U.S. 371 (1940); *Coastal Petroleum Co. v. U.S.S. Agri-Chemicals*, 695 F.2d 1314, 1319 (11th Cir. 1983). Accordingly, for purposes of the issue of *res judicata* herein, respondents concede that there is no distinction between a final order and a final judgment.

[13] Degnan, *Federalized Res Judicata*, 85 Yale L.J. 741, 744 (1976), emphasis added.

[14] 18 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure*, § 4468, p. 648 (1981).

recognize their "obligation to honor federal judgments without cavil."[15] The law is certainly so in California: "Full faith and credit must be given to a final order or judgment of a federal court." *Levy v. Cohen*, 19 Cal. 3d 165, 172 (1977) (citations omitted.) This Court has consistently so held. *E.g., Stoll v. Gottlieb*, 305 U.S. 165, 170 (1938), and cases cited therein.

B. A State Court, While Affording Full Faith And Credit To A Prior Federal Judgment, Must Itself Determine The Scope And Effect Of That Judgment Upon The Parties And Issues Before It

Having determined that a state court must give full faith and credit to a federal judgment neither ends the analysis nor indicates that a state court may not play an important role in determining the binding effect of a prior federal judgment. Professor Degnan says it well:

> A doctrine that a judgment is binding, however, does nothing to delineate its scope. There remains the question of *what issues*, and *what persons*, are concluded or bound. (Emphasis added.)[16]

Those were the questions presented to the California court.[17]

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[15] 18 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure, supra*, § 4468, p. 659.

[16] Degnan, *Federalized Res Judicata*, 85 Yale L.J. 741, 756 (1976).

[17] For example, National Union argued below that respondents were on constructive notice and were in privity with parties to the bankruptcy proceeding, and thus bound by its

The jurisdictional power of a state court to answer these questions and thus to determine the *res judicata* effect of a prior federal judgment is well ingrained in the law of federalism, including the decisions of this Court. For example, this unassailable concept was a foundation of this Court's unanimous decision in *Parsons Steel v. First Alabama Bank, supra,* 474 U.S. 518 (challenges to correctness of state court's determination of conclusive effect of federal judgment pursued by way of appeal through state court system and *certiorari* from this Court). Indeed, a state court's ability to make such determinations is so profound, within the concept of federalism, that *even if* the state court were absolutely wrong in its *res judicata*

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order; to the contrary, respondents argued that they had received no notice, made no appearance, and were not bound.

Indeed, at trial, counsel for National Union conceded that no attempt made to notify any of the injured third parties of the motion for order approving compromise, because National Union took the position that the injured plaintiffs had no rights in the D&O policy:

> The point is that plaintiffs were strangers to the [insurance] contract, and the plaintiffs had no rights under the D and O policy until they obtained judgments. And as of August of 1986 there were no judgments. Yes, they had an interest in the policy perhaps as any contingent claimant might have, but they had no right that they could demand to be notified.

RA A24-A25. However, the law makes it quite clear that, far from being "strangers" to the policy, respondents had interests in the liability policy which could not be annihilated without notice to them and an opportunity to be heard. *See* Part III(B)(1), *supra*.

conclusions, a "later" federal court would be *bound* to follow it.[18]

The manner in which the state court exercises its power to determine the preclusive effect of a prior federal judgment follows from the well-enunciated principles of *res judicata*. The touchstone is whether the party in the second suit, against whom preclusion is urged, was, in fact, a party to the first suit:[19]

> The basic premise of preclusion is that non-parties to a prior action are *not bound*. A non-party is *not precluded* from relitigating matters decided in a prior action simply because it passed by an opportunity to intervene. [Citations.] (*Valenti v. Mitchell*, 962 F.2d 288, 297 (3d Cir. 1992).)

Indeed the requirement that a party "against whom an estoppel is asserted had a full and fair opportunity to litigate is a most significant safeguard." *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation*, 402 U.S. 313, 329 (1971).

The California court decided that the respondents were not parties to the bankruptcy litigation, had not

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[18] *E.g., Matter of Brady, Texas Mun. Gas Corp.*, 936 F.2d 212 (5th Cir. 1991) (state court gave clearly erroneous *res judicata* effect to prior bankruptcy court order, even so, federal court was bound to give *res judicata* effect to that erroneous state court decision).

[19] By use of the term "party" we do not mean here to short change the doctrines of "privity" and "virtual representation" as they apply in this context. This aspect of the *res judicata* doctrine was urged below by National Union, and was rejected, as a *factual matter*, by the California court. PA 43a-46a.

received adequate notice thereof, and did not appear therein. The California court thus concluded, as it must, that the federal order would not estop respondents from seeking to have their rights in the third policy year determined. In so doing, the California court did exactly as this Court counseled in *Blonder-Tongue, supra*:

> Some litigants – those who never appeared in a prior action – may not be collaterally estopped without litigating the issue. They have never had a chance to present their evidence and arguments on the claim. Due process prohibits estopping them despite one or more existing adjudications of the identical issue which stand squarely against their position. See *Hansberry v. Lee*, 311 U.S. 32, 40 (1940); *Bernhard*, 19 Cal 2d, at 811, 122 P. 2d, at 894. (402 U.S. at 329.)

Thus the California court's determination – whether or not factually correct – was hardly an intrusion into federal jurisdiction or an evisceration of the federal judgment. In its petition, National Union argues that respondents were required to have the bankruptcy court determine whether the bankruptcy order bound them. But such is not the law of *res judicata*. *E.g., Parsons Steel v. First Alabama Bank, supra*. Parties are free to seek to have their rights vindicated in the "second court" and it is that "second court" that determines the scope of the first court's judgment.

> Disputes about the effect of a decision in one case on the prosecution of another are for the judge presiding in the *second case*. In the law of preclusion the *second court* normally determines the effect of the first judge's order. [Citations.]

(*Pettibone Corp. v. Easley*, 935 F.2d 120, 123 (7th Cir. 1991), emphasis added.)

The baton is picked up by the second court, even when that court is a state court, reviewing the *res judicata* effects of a federal judgment. *E.g., Merle Norman Cosmetics, Inc. v. Victa*, 936 F.2d 466, 468 (9th Cir. 1991) (affirming district court view that state court was in best position to evaluate preclusive effect of a federal court judgment; state courts are just as capable as federal courts in applying applicable law).

C. The Approach Of The California Court Was Totally Consistent With The Law Of Federalism, And The Result Of Its Decision Is Fact Specific, And Not Appropriate For Review Here

Contrary to the assertions here by petitioner, the decision of the California court in no sense ignored the bankruptcy court order or declared it a nullity. Indeed, the trial court noted that the compromise cancelling the D&O policy and providing for issuance of a new $5 million DIP policy was certainly valid and effective as between TEC and National Union, to provide coverage for post-bankruptcy events. PA 88a-89a. Further, the California court rejected any invitation to hold that the bankruptcy court order was not effective as between the parties thereto, for example, because the cancellation had violated the automatic stay of 11 U.S.C. §362. PA 33a n. 13. Indeed, the California court recognized that *had* the plaintiffs before it been parties to the bankruptcy proceeding and received adequate notice of the motion, they *would have* been bound. PA 70a.

Thus, at the end of the day, the compromise was valid between TEC and National Union, but did not affect the rights of the respondents.[20] Pursuant to the bankruptcy court order, TEC was not entitled to make any claim for corporate reimbursement against the $10 million third year coverage, and in return, TEC received a $5 million one-year policy covering its post-bankruptcy acts. On the other hand, the Helfands, and others similarly situated, were not deprived of their ability to make claims against the third year coverage because (i) under state law, their interests in that third year had sufficiently ripened and (ii) those interests could not be extinguished by litigation to which they were not a party.[21]

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[20] In an analogous situation, the Ninth Circuit Court of Appeals rejected the argument that a third party's declaratory relief suit involved a collateral attack on a bankruptcy court order approving a settlement agreement between the debtor and its bank. Although recognizing that the bankruptcy court did authorize and approve the settlement, the Ninth Circuit pointed out:

> This argument much over-states what the order of the bankruptcy court did. The bankruptcy court authorized [the company] to settle with the Bank of America. It did not purport to determine the effect of the settlement on Teerlink's lots. . . . There was nothing in the agreement and a fortiori nothing in the order of the bankruptcy court that barred Teerlink from seeking the declaration the district court issued. . . . *[T]here was no determination by the bankruptcy court of what the legal consequence was . . .*

In re Teerlink Ranch Ltd., 886 F.2d 1233, 1236 (9th Cir. 1989), cited by California Court of Appeal at PA 34a.

[21] *See* discussion of *Shapiro v. Republic Indemnity Co. of America, supra*, 52 Cal. 2d 437, holding that injured parties' rights against proceeds of insurance policy could not be mod-

Thus, the California court discharged its jurisdictional power in precisely the manner contemplated by this Court in *Parsons* – it made a *res judicata* determination with respect to the federal judgment. In so doing, the California court announced no new law nor sought to change bankruptcy law or any other federal law. The court simply answered, in a factual way, the traditional questions of the *res judicata* analysis: Were the Helfands given a full and fair opportunity to appear in the bankruptcy court and protect their interests in the liability policy? Given that the Helfands received no notice, was the notice given to the insured officers and directors sufficient to put them on notice that *their interests*, as opposed to TEC's, would be compromised? Were the Helfands "privies" to those who were clearly parties before the bankruptcy court?

Answering these questions, the California court focussed upon a number of factors peculiar to this case. For example, in determining the adequacy of notice to the respondent Helfands, the California court analyzed, in detail, a complicated factual pattern involving various persons whose "interrelationships" were the source of hot debate.[22] In the end, the California court made a

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ified by litigation solely between insured and insurance company.

[22] The court focussed upon the following factors, among others: (i) the agreement was described as a compromise solely between Technical Equities Corporation and National Union; (ii) the notice mentioned a $10 million liability limit suggesting a single policy amount and not the potential of three annual limits (as the court found to be the case); (iii) the notice did not suggest that $10 million in coverage could be eradicated by the

"fact-specific" determination that insulated the respondent Helfands from the *res judicata* plea of National Union.

> In a practical sense there was *no notice* that anyone was challenging or otherwise attempting to adjudicate the rights of officers and directors as insureds under the policy vis-a-vis their insurer. Therefore, these are not matters that "could have been litigated" at the compromise hearing. (*Chicot County Dist. v. Bank, supra,* 308 U.S. at p. 375 [84 L.Ed. at p. 333].) (PA 41a.)

Certainly, at bottom, it is this factual determination that forms the real basis of the dispute between petitioner and respondents. It is not a question of exclusive federal jurisdiction. It is not a question of state court subject matter jurisdiction. It is not a question of comity, federalism, or anything like that. It is simply a question of whether or not the state court's factual determination that the Helfands were not bound by the bankruptcy order under the doctrine of *res judicata* was correct. Two courts in California have spoken on this issue and this Court should not disturb those factual determinations.

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compromise; (iv) the notice did not target the individuals who were impacted by the third year policy proceeds; and (v) written objections were to be filed in a short period of time. PA 27a-29a, 32a, 36a-41a.

V. CONCLUSION

For all of the foregoing reasons, plaintiffs and respondents herein pray that the petition for writ of certiorari be denied.

DATED: July 22, 1993

Respectfully submitted,

COTCHETT, ILLSTON & PITRE
JOSEPH W. COTCHETT
SUSAN ILLSTON
MARIE SETH WEINER*
THOMAS T. ANDERSON & ASSOCIATES
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RESPONDENTS' APPENDIX

FILED
APR 14 1987

WILLIAM L. WHITTAKER
Clerk, U.S. District Court
Northern District of California
SAN JOSE

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

LEONARD HELFAND, et. al. Plaintiffs, vs. NATIONAL UNION FIRE INSURANCE CO. OF PITTSBURGH, PA, et. al. Defendants.	No. C 86-20855 SW ORDER GRANTING MOTION TO REMAND

Plaintiffs filed a complaint alleging negligent misrepresentation and breach of fiduciary duties against the directors and officers of Technical Equities Corp. (hereinafter referred to as TEC) after the firm filed for bankruptcy under Chapter 11. That action was coordinated with other similar complaints and is pending in Santa Clara County Superior Court.

Plaintiffs subsequently brought this declaratory relief action against defendant National Union, an insurance company which provided TEC with a $10 million liability

policy. Also named as defendants are nineteen TEC directors and officers, and DOES 1-100. The present action regards this insurance policy and the costs of defending the underlying claims against TEC. Plaintiffs claim that defendant National Union is deducting the costs of defending TEC's directors and officers from the policy limit, thereby depleting the $10 million fund. Plaintiffs seek a judicial determination of the interpretation and enforceability of the policy provision, and a judgment declaring that the $10 million does not include the costs of defending the directors and officers in the underlying actions.

This action was originally filed in state court. Defendant National Union subsequently removed the case to federal court on grounds of federal question and diversity jurisdiction. On March 6, 1987, this court took two motions under submission without oral argument: plaintiffs' motion to remand and defendant National Union's motion to dismiss.

MOTION TO REMAND

1) Diversity Jurisdiction

There must be complete diversity to invoke this court's jurisdiction pursuant to 28 U.S.C. § 1332, and it is the moving party's burden to prove that complete diversity exists. *Littlefield v. Continental Cas. Co.*, 475 F. Supp. 887, 889 (C.D. Cal. 1979). Plaintiffs are California residents, while defendant National Union is incorporated in Pennsylvania with its principal place of business in New York. However, seventeen of the defendants, all of whom are TEC directors and managers, are California residents.

National Union asserts that these defendants' interests are identical with the interests of the plaintiffs, and therefore asks this court to realign all defendants (except itself) as party plaintiffs. Plaintiffs move to remand this case to state court, claiming that this court lacks jurisdiction under § 1332 because their interests are not the same as the defendants' and realignment of the parties is inappropriate.

It is the court's duty to look beyond the pleadings and align the parties according to their interests in the litigation. *Indianapolis v. Chase National Bank*, 314 U.S. 63, 69-70 (1941). This requires the court to ascertain the "primary and controlling matter in dispute." *Id. at* 69. Thus, if the defendants' interests coincide with the plaintiffs' interests in relation to the purpose of the lawsuit, then the court must realign these defendants as party plaintiffs. *Dolch v. United California Bank*, 702 F.2d 178 (9th Cir. 1983).

Plaintiffs and the individual defendants do share at least one common goal: both parties want to preserve the $10 million to pay for any potential liability of TEC's directors and officers in the underlying actions. However, the individual defendants rely on defendant National Union's policy to pay for their defense costs, and in this action these defendants are primarily concerned with receiving funds for their defense in the underlying litigation. Conversely, plaintiffs' main purpose in this action is to ensure that the costs and expenses incurred in defending the directors and officers do not reduce the $10 million. This court does not agree with defendant National Union that the individual defendants' interests are identical with the interest of the plaintiffs, and therefore

declines to realign the parties. Therefore, this court finds that defendant National Union cannot invoke this court's jurisdiction pursuant to 28 U.S.C. § 1332.

2) Federal Question Jurisdiction

Defendant National Union also asserts that this court has jurisdiction over this case pursuant to 28 U.S.C. § 1334(b) because this action is "related to" a bankruptcy proceeding. However, this case seeks to interpret the language of the policy, and does not address the question of whether the policy proceeds are or are not assets of the bankruptcy estate. Because defendant National Union has not established that a relationship exists within the meaning of § 1334(b) between this case and any proceeding under the Bankruptcy Code, this court finds it does not have jurisdiction pursuant to § 1334(b).

MOTION TO DISMISS

Because the court has determined it lacks jurisdiction over this proceeding, it cannot rule on the merits of defendant National Union's motion to dismiss.

Accordingly, this court GRANTS plaintiffs' motion to remand this proceeding to state court.

IT IS SO ORDERED.

Dated: 4-13-87

s/
Spencer Williams
United States District Judge

[EXCERPT OF TRANSCRIPT OF
A BANKRUPTCY COURT HEARING]

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

BEFORE: THE HONORABLE LLOYD KING, JUDGE

IN RE TECHNICAL EQUITIES CORPORATION, DEBTOR.	)	CASE NO. 3-86-00366LK CHAPTER 11
TECHNICAL EQUITIES CORPORATION, THROUGH ITS OFFICIAL UNSECURED CREDITORS' COMMITTEE, PLAINTIFF, v. NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA., ET AL., DEFENDANTS.	)	ADVERSARY PROCEEDING NO. 3-86-0449LK
AND RELATED CROSS AND COUNTERCLAIMS	)	

FRIDAY, OCTOBER 30, 1987 – 10:00 A.M.

REQUEST FOR INJUNCTIVE RELIEF
MOTIONS FOR CLASS CERTIFICATION
MOTION FOR FEES AND COSTS

* * *

THE COURT: All right. The matter is submitted and the request for this injunctive relief and Class Certification will be denied.

First, on the Interpleader Action there is the question of whether or not some injunctive relief is necessary for the protection of the fraud.

There are two basics [sic] problems with that.

First, because of the unresolved question of whether or not this is a self-consuming fund, it's not clear that protection is necessary.

And it's further clear that that question will not be resolved with the finality by the Courts of the State of California for a long time.

The question would appear to be one that's still important to all interests concerned.

Appeals are going to be pursued if the litigation is pursued and those will not be resolved swiftly.

Assuming that this is a self-consuming fund, there are competing interests of equal importance. Namely, the interests of those involved in the litigation in the coordinated litigation for want of a shorthand term.

Therefore, if it turns out that the fund is consumed it would appear that it would be consumed for a legitimate purpose and that the interest in preserving this fund is not of sufficient magnitude that injunctive relief is inappropriate.

Those same considerations really apply to the suggestion of any general injunctive relief based upon the

inherent or equitable or even the statutory power of the Court under the All-Risk Statute.

There are important competing interests on both sides.

Mr. Alexander's clients, particularly, I believe, are aggrieved parties by the failure to issue an injunction. Because, as the proceeds are consumed for their defense – if this is a self-consuming policy – then necessarily, the amount of proceeds available to satisfy any judgment exposure that they may have, is diminished.

Nevertheless, I understand that risk, that harm and – balancing the competing interests, feel that the injunctive relief is inappropriate.

As far as Class Certification is involved, I am in agreement with the argument, certain of the basic prerequisites of Rule 23-A are not met.

This Class is not so numerous that joinder of all the members is impractical and can be seen here.

And that's Sub-division 1 of Rule 23-A and also Subdivision 4 requires that the representative parties will fairly and adquately [sic] protect the interests of the Class.

As has been pointed out, there is a direct litigation beteween [sic] certain members of the proposed Class that would not be possible to get a representative to represent all.

And there seem to be numerous parties who have their own counsel. Those counsel have been involved in this litigation for a considerable period of time.

The efforts in the coordinated litigation are proceeding and the ability of single representatives to fairly and adequately protect the Class does not seem to be achievable.

I believe it goes without saying that I am dening [sic] the request of the Drysdale parties that a ruling on this motion be deferred pending the hearing before Judge Ingram. There may or may not be satisfactory alternatives.

I want to back up to the Class Certification question.

In view of the determination under Subdivision A of Rule 23, I don't find it necessary to discuss or pass upon the issues that the parties have raised about whether or not classes – specific kinds of classes can be maintained under Rule 23-B.

There may be alternative methods to that which is suggested as Mr. Benvenutti has pointed out correctly though. Even the alternative suggested by the Court has some inherent questions and is by no means a complete resolution.

There's a question frankly, about the focus on the Bankruptcy Court.

The interests of the Bankruptcy Court in this litigation is a little different and perhaps, somewhat diminished in view of the confirmation of the plan of reorganization.

This is not like some other major re-organizations where the settlement of class and securities' litigation becomes an integral part of the re-organization.

Here, the Bankruptcy Estate is basically a claimant along with hundreds of others.

And I don't think it's appropriate to over-emphasize the role of the Bankruptcy Court just because the Bankruptcy Estate or the Creditor's Committee is a party.

In the big picture which is the recovery of damages, the Estate in Bankruptcy is a competing claimant along with many others. But that's really all that it is. Whether or not these proceeds are property of the estate is a far from answered question.

I think that many serious points have been raised in the argument today that suggest that an affirmative answer to that question would take some doing.

And if anyone wants to raise that question I certainly would be happy to consider it and rule upon it.

I have considered the suggestion by Mr. Perlis and that is that there be a brief injunction to get the parties going toward settlement.

Efforts toward settlement have been going on for a long time in Court and even out of Court.

I notice that Barbara Phillips was here for a considerable portion of the hearing and I don't think that a brief stay is going to be an effective vehicle of bringing about a resolution.

If I thought it would bring everyone to their senses, that would be fine. But instead, I see the brief stay as perhaps more of an interference with the coordinated litigation than a positive step.

Somebody raised the point that I was presented with the alternative of an injunction or inaction or some such and I suppose that's true.

And it's necessary in litigation of this nature that judicially, a strong hand be taken. But here, frankly, the question is: Where should it be taken?

And again, I am persuaded that it has been taken. And if too many strong hands are taken then there can be confusion ultimately, rather than progress.

It's been suggested that this ruling may, in fact, render the Interpleader moot. And I think that is a legitimate prospect. And again, a prospect that has been considered and weighed.

The denial of the requests for injunctive relief and Class Certification is without prejudice to renewal should there be a determination that the Estate in Bankruptcy – let me put it differently.

That the proceeds of the policy, in fact, constitute property of the Estate.

And when I say "the proceeds of the policy" I in fact, mean either all or a portion of the proceeds of the policy.

Again, stressing that I am not at this point persuaded that there would be an affirmative answer to that question.

But certainly have not had an adequate opportunity, fully, to address that.

I believe that for purposes of Rule 52-A of the Federal Rules of Civil Procedure and Bankruptcy rule 7052, my

comments for the record will serve as a Statement of Reasons.

Mr. Buckley, will you please undertake to prepare an appropriate order?

I will not require that it be approved as to form because that process might make a substantial encouragement [sic] into the policy proceeds, I suspect.

Why don't you submit it with a transmittal letter, suggesting that it be lodged for a period of ten days to give other parties an opportunity to comment?

MR. BUCKLEY: I will, your Honor.

* * *

FILED
JAN 30 1991

RICHARD W. WIEKING
CLERK, U.S. DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, Plaintiff, v. AARONSON, DICKERSON, COHN & LANZONE, a Professional Corporation, *et al.*, Defendants.	No. C-90-20561-WAI MEMORANDUM OF DECISION

The application of plaintiff National Union for a preliminary injunction restraining the enforcement of any judgment which may be rendered against plaintiff in the six coordinated bad faith cases now on trial in Superior Court is denied.

The request of the Kouns defendants for a hearing of their request for sanctions against plaintiff for purported violation of Rule 11 F.R. Civ.P., is granted, but hearing is deferred until after trial on the issue of a permanent injunction, if there is such a trial.

This matter is here because the plaintiff seeks relief under the provisions of the third exception to the Anti-Injunction Act, 28 U.S.C. § 2283, and under the All Writs Act, 28 U.S.C. § 1651.

The judgment which plaintiff seeks to effectuate and protect is an order entered by the U.S. bankruptcy court for this district which approved a compromise between plaintiff herein, National Union Fire Insurance Co. and the debtor in possession in the matter then before the bankruptcy court, Technical Equities Corp.. The compromise concerned a dispute over National Union's cancellation of a policy issued by it to Technical Equities which insured the Directors and Officers of Technical Equities for a period commencing August 5, 1984 and expiring August 5, 1987 against claims made against the officers and directors. Technical Equities collapsed sometime in 1986 and filed for Chapter XI protection. After that National Union cancelled coverage for what was left of the second year of coverage, slightly less than a month, and all of the third year coverage. Technical Equities objected to this on the basis that the act of National Union violated the automatic stay. The parties resolved the dispute through compromise by the terms of which National Union cancelled the coverage above referred to, but issued a new policy covering the officers and directors for claims made after the bankruptcy was filed and was pending. The bankruptcy court held a hearing on that and other related matters pertaining to the Bankruptcy Estate on July 28, 1986 and approved the compromise.

Plaintiff now contends that the order constituted a judgment which is *res judicata* as between the parties to the compromise and to their privies and bars the entry of

any judgment against National Union in the presently ongoing state bad faith actions to the extent that the judgments are predicated on continuing coverage of the directors and officers for the policy period cancelled by National Union pursuant to the agreement of compromise.

The reason the case is here is that National Union has invoked two federal statutes, the Anti-Injunction Act, 28 U.S.C. § 2283, and the All Writs Act, 28 U.S.C. § 1651, in support of its effort to persuade this court to call a halt to an element of the ongoing state court proceedings.

The factual situation is rendered more murky than otherwise by the fact that the bankruptcy court judge, King, C.J., rendered subsequent decisions which strongly indicate that he had no intention of effecting matters of coverage, policy limits and the like, but was leaving such determinations to the state court judge who was presiding over the state coordinated proceedings.

For example on July 28, 1986 King approved the compromise over the D&O policy. On October 30, 1987 National Union sought a preliminary injunction from Judge King, enjoining the then ongoing state and federal actions. This request was refused. On April 29, 1988 National Union sought a Finding that the Order of July 28, 1986 had limited coverage under the D&O Policy to $10 million. This, and the accompanying motion for preliminary injunction of ongoing state and federal court litigation, were denied by King on June 22, 1988. The grounds for this denial are not readily apparent. On November 22, 1989 King ordered that the bankruptcy

court would retain jurisdiction over the CGL Policy proceeds and their administration, but that it would abstain from deciding issues of interpretation. On August 27, 1990 Judge Rushing entered judgment in the *Helfand* action, holding that the D&O Policy was not self-consuming and that its value was $10 million per policy year for each of the three years of coverage. In addition, Rushing ruled that the previous bankruptcy court order did not amount to *res judicata* against the plaintiffs in *Helfand*.

Little over one week later, on September 7, 1990, King tentatively granted the *Helfand* plaintiffs motion for complete abstention from determination of all remaining issues in the interpleaded action. This order was conditioned only upon the finding of a suitable mechanism to distribute the interpleaded funds.

All this causes me to wonder why plaintiffs chose this district court in which to seek injunctive relief rather than the bankruptcy court which made the order whose preclusive effect is in issue here. As was observed in *Bechtel Petroleum Inc. v. Webster*, 796 F.2d 252 (9th Cir. 1986),

> Judge Orrick was in the best position to assess the strength of this litigation as he was the same judge who presided over the federal FLSA enforcement proceeding which is the alleged basis for the res judicata preclusion.

The bankruptcy court has the power to exercise its discretion in acting on a motion such as the one presently before this court.

> The bankruptcy court is empowered to enjoin state court actions when it is appropriate under

> Code Section 105(a) which provides: 'The bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.' This section acts as 'authorization' as required by 28 U.S.C. § 2283, for a court of the United States to stay the actions of a state court. *In re McCools Boxed Beef Corp.*, Bkrtcy., 24 B.R. 462 (1982).

However, as plaintiff has pointed out, the case may properly be filed before this court.

A decision whether or not to enjoin a state court proceeding pursuant to the narrow exceptions of the Anti-Injunction Act is committed to the discretion of the district court.

> Doubts as to the propriety of a federal injunction against state court proceedings should be resolved in favor of permitting the state courts to proceed in an orderly fashion to finally determine the controversy. *Golden v. Pacific Maritime Association*, 786 F.2d 1425 (9th Cir. 1986); *Atlantic Coast Line Railroad Co. v. Brotherhood of Locomotive Engineers*, 398 U.S. 281 (1970).

The fact that a federal court has the power to enjoin state proceedings in order to protect its own does not mean that it is appropriate to exercise that authority in every instance. Whether an injunction should issue depends upon several factors including whether or not the issuance is in the interest of equity, comity and federalism. *United Transport Union v. Long Island Railroad*, 509 F.Supp. 1300 (E.D.N.Y. 1980).

After careful examination of all the filings before me and of the oral argument of counsel I am convinced that

basic principles of comity and federalism in this instance preclude issuance of a preliminary injunction.

With respect to the circumstances of the issuance of the Order and totality of actions taken with respect to the subject matter of the order there are troubling questions:

1. To what extent did defendants herein, who are plaintiffs in the actions sought to be enjoined, have notice of the proceedings in which the compromise agreement between National Union and Technical Equities was approved by the bankruptcy court? A quick review of the record shows, through the Affidavit of Michael F. Perlis, that 23 of the 1,571 investor plaintiffs were mailed notice.

2. To what extent were the investor defendants herein virtually represented at the hearing on the motion for approval of compromise? Present at the July 28, 1986 hearing were counsel for the Creditor's Committee and counsel for a putative class of investor who were allegedly defrauded by Technical Equities Corporation. However, those counsel were before the court on *other motions* unrelated to the motion for Approval of Compromise and did not participate in that motion. (See Ex. L to Declaration of Marie Seth Weiner). Far from being "virtually represented" for that hearing, the investor defendants herein were virtually unrepresented by anyone.

3. Was the form of notice adequate to inform those who were served with it as to the nature of the compromise, and the necessary effect of it on persons in the position of the investor defendants herein? Judge Rushing of the Superior Court has ruled that the notice was deficient. (See Declaration of Weiner, Ex. F, p.23).

4. Was there privity between the investor defendants herein and anyone who had notice of the hearing and represented the interests of the investor defendants herein with the authority to do so? (cf. *United States v. ITT Rayonier, Inc.*, 627 F.2d 996 (9th Cir. 1980).)

5. To what extent can contractual rights under an insurance policy be effectively cancelled as to parties aggrieved by the insured risks, where the risk insured against has occurred prior to the cancellation?

These and perhaps other questions have been presented to the Superior Court and are now presented to this court. Two companion cases to those here involved have been fully tried in Superior Court and are now on appeal to the California Court of Appeal for the First Appellate District, Division Four, and are not as yet determined. Those cases, *Helfand v. National Union, et al.*, No. 615589 and 654728, *McLaughlin v. National Union*, No. 666389, (coordinated under No. 600306), present the same issues that are presented in the instant proceedings. Those cases and the six coordinated cases sought to be enjoined have been pending for many years and have moved completely through the California court system to and including trial, and in two of the cases to and including judgment without any application of the sort now before this court having been made.

Enormous expenditures of time, effort and money have been made in connection with those cases. As indicated in Judge Rushing's *Helfand* opinion (Ex. F to Declaration of Weiner) many of the plaintiffs are elderly and have been accorded their statutory preference for rapid resolution of their cases.

The issues have been properly and squarely presented to the California Appellate courts.

It is worthy of note that the relitigation exception to the Anti-Injunction Act was aimed at preventing the costly and judicially wasteful determination of issues in state court after full litigation in federal court. *Quintero v. Klaveness Ship Lines*, 914 F.2d 717 (5th Cir. 1990). To the extent that this is a germane consideration it is without application in this case where, with the acquiescence of plaintiff, the cases sought to be enjoined have proceeded for years through the state courts and have been in trial since October, 1990. More than four years have passed since the entry of the bankruptcy court order in issue, and apparently no effort has ever been made to invoke the relitigation exception until late last year. The expense and effort shoe is precisely on the other foot in this instance. The effort and expense which led to the bankruptcy court order in issue is a drop in the bucket when compared to the time, effort and money devoted to the coordinated proceeding with respect to the cases involved in this proceeding.

As Judge Wisdom said in *Southern California Petroleum Corp. v. Harper*, 273 F.2d 715, 719 (5th Cir. 1960),

> We take the view that a complainant must make a strong and unequivocal showing of relitigation of the same issues in order to overcome the federal courts' proper disinclination to intermeddle in state court proceedings. If we err, all is not lost. A state court is as well qualified as a federal court to protect a litigant by the doctrines of res judicata and collateral estoppel.

Mindful that doubts as to the appropriateness of an injunction should be resolved "in favor of permitting the state courts to proceed in an orderly fashion to finally determine the controversy" (citation omitted) *Bechtel Petroleum Inc. v. Webster, supra.* I am strongly of the opinion that for the reasons stated, the doubts strongly outweigh the propriety of intervention.

Furthermore, in *Mitchum v. Foster,* 407 U.S. 225 (1972) the Supreme Court noted that in civil cases the court had not yet decided the precise parameters of exceptions to the Anti-Injunction Act. These were established in criminal case application by *Younger v. Harris,* 401 U.S. 37 (1971) but the Court noted that even where there is an apparently applicable exception the court to which the application is directed must consider the appropriateness of injunction relief in the light of principles of equity, comity and federalism.

Parsons Steel Inc. v. First Alabama Bank, supra goes a considerable distance in filling the void noted by the Court in *Mitchum* with respect to civil cases.

The case holds that after a final state court judgment is entered the Full Faith and Credit Act entitles the judgment to preclusive effect, meaning that federal courts must accord such a judgment the same effect as another court of the same state would give it. In such a situation the relitigation exception to the anti-injunction statute has no application at all, because to apply it would impermissably [sic] limit the Full Faith Credit Act.

Here the parties sharply dispute whether or not the judgments in *Helfland* [sic] and *McLaughlin* are to be

regarded as final even though the appellate decisions have not yet been rendered.

Plaintiff relies on *Agarwal v. Johnson*, 25 Cal.3d 932 (1979), *Camp v. Mendocino County Board of Supervisors*, 123 Cal.App.3d 334 and *People ex rel Gow v. Mitchell Brothers' Santa Ana Theater* 101 Cal.App.3d 296 (1980), all of which hold that a judgment is not final for res judicata purposes when appealed until the exhaustion of the appellate process.

Defendants rely strongly ont [sic] he [sic] language of *Parsons* at 474 U.S. 525,

> Challenges to the correctness of a state court's determination as to the conclusive effect of a federal judgment must be pursued by way of appeal through the state court system and certiorari from this Court.

Defendants suggest also that the conclusive effect of a judgment in a coordinated proceeding, such as the one here sought to be enjoined, provides an exception to the finality of judgment rule otherwise applicable because of the necessity of compliance with CCP 36(a) which is a mandatory provision requiring the trial of cases of elderly plaintiffs within a limited time after filing of the at issue memorandum. The practical result of the application of this exception is that the state trial court in the cases here sought to be enjoined employed offensive collateral estoppel to preclude the trial of certain issues which were decided adversely to plaintiff herein in the cases sought to be enjoined. This court does not express an opinion on these important questions of California law

because it is not necessary to do so in order to decide the instant case.

Whether the decision of the trial court constitutes a final judgment within the meaning of the *Parsons* case and constitutes an absolute bar to the application of the relitigation exception is not the predominant issue because even though it does not constitute such a bar, this is not a proper case for the application of the relitigation exception because to apply the exception and to grant the injunction would be an unwarranted and unconscionable intrusion upon California processes, wholly at odds with principles of federalism, comity and equity. Cf. *Mitchum v. Foster, supra.*

The aftermath of the Technical Equities bankruptcy including the number of suits and parties litigant, the age of many of those parties, the failure of plaintiff herein to seek this relief through the four or more years that the cases sought to be enjoined have pended, the surrounding circumstances of the issuance of the bankruptcy court order, the actions of the bankruptcy court following the issuance of the order of August 5, 1986, the lack of cognizable irreparable injury to plaintiff[1] have all been weighed by me, and I conclude that plaintiff's application must be denied, and IT IS HEREBY DENIED.

DATED: 1/ 28/ 91

s/
WILLIAM A. INGRAM
United States District Judge

[1]Although National Union has argued that a party seeking injunctive relief under the relitigation exception need not show irreparable injury in order to prevail, the cases cited in favor of this proposition do not actually state that an irreparable injury showing is not required. To the contrary, the court finds the defendants' position, that the same equitable standards apply to injunction obtained under the relitigation exception as apply to all injunctions, to be persuasive. Although neither *White Mountain Apache Tribe v. Smith Plumbing Co.*, 856 F.2d 1301 (9th Cir. 1988) nor *Goldie's Bookstore v. Superior Court*, 739 F.2d 466 (9th Cir. 1984) expressly state that irreparable injury must be shown, both directly imply this requirement by overturning injunction issued by the district court because no irreparable injury was demonstrated. *See also* C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure*, § 4226 at 551 (2d ed. 1988).

[EXCERPTS FROM THE *HELFAND* TRIAL TRANSCRIPT]

IN THE SUPERIOR COURT OF
THE STATE OF CALIFORNIA

IN AND FOR THE COUNTY OF SANTA CLARA

COURTROOM 100

BEFORE HONORABLE CONRAD L. RUSHING, JUDGE

IN RE TECHNICAL EQUITIES LITIGATION	COORDINATED PROCEEDINGS
	MASTER FILE NO. 1991
THIS DOCUMENT RELATES TO:	SANTA CLARA COUNTY SUPERIOR NO. 600306
HELFAND VS. NATIONAL UNION, ET AL., AND RELATED CROSS-ACTIONS.	
SANTA CLARA SUPERIOR NO. 615589	

SANTA CLARA, CALIFORNIA, MAY 22, 1989

9:15 O'CLOCK A.M.

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* * *

[MR. ROBINSON:] WITH RESPECT TO WHETHER OR NOT THE PLAINTIFFS WERE ENTITLED TO WITNESS, I AM NOT TALKING, NOW, ABOUT D AND O, BUT THE PLAINTIFFS, INJURED INVESTORS. THEY CLAIM THAT THEY WERE NOT PRESENT AT THE BANKRUPTCY HEARING AND, THEREFORE, THAT

SOMEHOW NEGATED THE VALIDITY OF JUDGE KING'S ORDER.

THE POINT IS PLAINTIFFS WERE STRANGERS TO THE CONTRACT, AND THE PLAINTIFFS HAD NO RIGHTS UNDER THE D AND O POLICY UNTIL THEY OBTAINED JUDGMENTS. AND AS OF AUGUST OF 1986 THERE WERE NO JUDGMENTS. YES, THEY HAD AN INTEREST IN THE POLICY PERHAPS AS ANY CONTINGENT CLAIMANT MIGHT HAVE, BUT THEY HAD NO RIGHT THAT THEY COULD DEMAND TO BE NOTIFIED AND, THEREFORE, THE LANGUAGE OF THEIR NOTICE IS IRRELEVANT TO THE EFFICACY.

THE COURT: WHOSE LACK OF NOTICE?

MR. ROBINSON: TO THE PLAINTIFFS THEMSELVES, THE INJURED PARTIES. THEY MAKE A BIG POINT OF SAYING, "WE WEREN'T THERE. THEREFORE, THE WHOLE PROCEEDINGS WERE CORRUPTED SOMEHOW WITH ERROR." AND I AM MAKING THE POINT THAT THEY WERE NOT ENTITLED TO NOTICE EVEN THOUGH THEY MAY OR MAY NOT HAVE HAD ACTUAL NOTICE. I DON'T KNOW WHAT THE STATE OF AFFAIRS WAS, BUT THERE WAS NO POLICY PROVISION THAT REQUIRED THAT THIRD PARTY CLAIMANTS, STRANGERS TO THE CONTRACT, BE NOTIFIED OF ANYTHING AFFECTING THE POLICY.

* * *